

Properly Substantiating the §199A Qualified Business Income Deduction

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NSTP's Suggested Research Materials

- Internal Revenue Code **§199A**
- IRS Regulations **§1.199A-1 through §1.199A-6**
- **NSTP Webinar UU.1**: Overview of **§199A** Qualified Business Income Deduction, at <https://www.nstp.org/webinar.php>
- IRS Website: “Tax Cuts and Jobs Act, Provision 11011, **§199A** Qualified Business Income Deduction **FAQs**”



Qualified Business Income Issues

- **§162** Trade or Business
- Pass-through of the net amount of items of income, gain, deduction and loss
- Taxpayer's responsibility to prove
- Combined **Qualified Business Income**
- **Relevant Pass-through Entity: RPE**
- Negative **Qualified Business Income**



Qualified Business Income Issues

- Specified **S**ervice **T**rade or **B**usiness: **SSTB**
- Temporary Provision: **2018-2025**
- Only income effectively connected with a **U.S.** trade or business
- Special rules for specified agricultural or horticultural cooperatives **§199A(g)**
- Threshold amounts based on the individual taxpayer's filing status



§ 199A Pass-through Entities

- Sole-proprietorships: **Schedule C, Form 1040**
- Partnerships: **Form 1065, Schedule K-1**
- Subchapter S Corporations: **Form 1120S, Schedule K-1**
- Estates & Trusts: **Form 1041, Schedule K-1**



§ 199A Pass-through Entities

- Publicly Traded Partnerships (PTP): Form 1065, Schedule K-1
- Real Estate Investment Trust Dividends: Form 1099-DIV, Box 5
- Specified Agricultural or Horticultural Cooperative Dividends: Form 1099-PATR, Box 7 Qualified Payments



Not Included in QBI

- Trade or business of being an employee:
 - *“Once an employee always an employee”*
- Guaranteed payments to partners
- Investment income:
 - ✓ Nothing on Schedule B
 - ✓ Nothing on Schedule D
- Trades or businesses that are **C** Corporations



Specified Service Trade or Business

- Health
- Law
- *Accounting*
- *Actuarial Science*
- *Performing Arts*
- *Consulting*
- *Athletics*



Specified Service Trade or Business

- Financial Services
- Brokerage Services
- Investing and Investment Management
- Trading
- Dealing in Securities
- Dealing in Partnership Interest
- Dealing in Commodities



Specified Service Trade or Business

- *Any Trade or Business where the “principal asset” of such trade or business is the “reputation or skill” of one or more of its’ employees or owners*



Threshold Amount Based on Filing Status

- Single and Married Separate: **\$157,500 to \$207,500**
- Married Joint: **\$315,000 to \$415,000**
- Indexed to inflation for tax years *after 2018*:
 - **\$160,700 - \$210,700 Single & HHH**
 - **\$321,400 - \$421,400 Married Joint**
 - **\$160,725 - \$210,725 Married Separate**



Substantiating Allowable Deductions

- Generally, the law does not require any *specific* kind of records to be kept
- Taxpayer can choose *any* recordkeeping system suitable that *clearly* reports **allowable deductible** amounts
- *Electronic* records require same type of information as *hard copy* books & records
- Supporting documents are **required** in order to substantiate the **§199A** deduction



Substantiating Allowable Deductions

- Tax Court *disallows* deductions **not** substantiated
- Sloppy record keeping
- **§6662** provides for the assessment of a **20%** accuracy related penalty for substantial understatement of tax if the understatement is *more than the greater of:*
 - **10%** of the tax required to be reported on the return,
or
 - \$5,000
- Considered *negligence and disregard for the rules and regulations*



Substantiating Allowable Deductions

- **§6662(d)(1)(C)**: added by the **Tax Cuts and Jobs Act**, provides that the **20%** accuracy related penalty will be imposed **if** the understatement is *more than* the *greater of*:
 - **5%** of the tax required to be reported on the return, or
 - \$5,000
- **Audit proof** the deduction: assume that *every* return prepared will be audited



Operational Rules: Reg. §1.199A-2

- Guidance on calculating a trade or business's:
 - Properly allocable W-2 Wages, and
 - **Unadjusted Basis Immediately After Acquisition** of all qualified property (**UBIA** of qualified property)
- The amount of each partner's or shareholder's W-2 wages and UBIA that is passed-through is based on the proportion of the ownership in the pass-through entity



Properly Allocable W-2 Wages

- Wages with respect to any person for any *taxable year during a calendar year ending in a taxable year*
- For wages paid to employees (or former employees): *“Once an employee always an employee”*
- Officers of a Subchapter S
- Employees of an individual
- Employees of a **Relevant Pass-through Entity (RPE)**



W-2 Wages Must Be Properly Reported

- “**W-2 Wages**” does **not** include *any amount* that is not “properly included” in a return filed with the **Social Security Administration** *on or before* the **60th** day *after* the due date for such return
- Reg. **§31.6051-2** states that **Form W-2** and **Form W-3** “together constitute an information return to be filed with the **Social Security Administration**” (same rule applies for Form **W-2c** and Form **W-3c**)



W-2 Wages Must Be Properly Reported

§6071(c) provides that Forms W-2 and W-3 must be filed *on or before* **January 31** of the year *following the calendar year*

Corrected returns filed *on or before* the **60th** day to correct *timely filed* returns are accepted as “properly reported” for purposes of the **§199A deduction**



W-2 Wages Must Be Properly Reported

- **Corrected** returns filed *after* the **60th** day to correct *timely filed* returns are subject to the following:
 - ✓ If the **corrected amount** is *greater than the original amount*, then the *original amount* is the “properly reported” amount
 - ✓ If the **corrected amount** is *less than the original amount*, then the *lesser amount* is the “properly reported” amount



W-2 Wages Must Be Properly Reported

- Any W-2 and W-3 Forms filed *after the 60th day after the January 31* due date are *not* “properly reported” and the W-2 Wages for purposes of the § **199A deduction** is **ZERO!**



W-2 Wages Must Be Properly Reported

- Short tax years
- Commonwealth of Puerto Rico
- Allocation of wages if more than 1 trade or business which generated QBI
- Reflected on Schedule K-1 if RPE



Substantiation of UBI of Qualified Property

- **Qualified Property** with respect to *any* trade or business of an individual or **Relevant Pass-through Entity (RPE)** means:
 - **Tangible** property *allowed for depreciation* under **§167(a)**
 - Held by, and available for use in a trade or business *at the end* of the taxable year,
 - Used at any point *during the taxable year* in a trade or business's production of QBI, and
 - The *depreciable period* has not ended *before the close* of the individual's or RPE's taxable year



Depreciable Period Defined

- The period:
 - **beginning** on the date the property was **first** placed in service by the individual or RPE and
 - **ending** on the *later of*:
 - ✓ The date that is **10 years** *after the placed in service date*, or
 - ✓ The *last day* of the *last full year* in the *applicable recovery period* that would apply under **§168(c)**



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NSTP THANKS YOU!

- We invite you to come see us at our booth in the Exhibit Hall so that you can learn more about the **“Benefits of Membership” in NSTP**
- We also ask that you attend our presentation on **“Tax Cuts and Jobs Act (TCJA): Things Learned During the 2019 Filing Season”** on Wednesday & Thursday morning at **8:00 AM in Room 1**



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